

DS Smith Plc
Pre-Close Statement – 25 April 2012

Speaker key

LO Louise (operator)
MR Miles Roberts DS Smith
SD Steve Dryden DS Smith
RG Ross Gilardi Bank of America Merrill Lynch
MA Marcus Almerud Morgan Stanley
HF Hector Forsythe Oriel Securities

LO Good morning, ladies and gentlemen, and welcome to the DS Smith pre-close statement. My name is Louise. I'll be the coordinator for today's conference. For the duration of this call, you will be on listen only. However, at the end of the presentation, you will have the opportunity to ask questions. If, at any time, you need assistance, please press star, zero, on your telephone keypad, and you'll be connected to an operator. I'm now handing you over to Miles Roberts, to begin.

MR Hi, good morning. I'm Miles Roberts, the CEO of DS Smith, and I'm joined by Steve Dryden, our finance director. Thank you for your time this morning.

We have released our pre-close trading update. This is for the year to the end of April. We're very pleased with progress. However, as many of you know, we are restricted in what we say, because of the rules and regulations that we're subject to, being in the middle of reverse takeover. However, with that in mind, I will do our best to get across how pleased we are with the progress made this year.

But if I could start by taking a few minutes to run through some highlights, after which Steve and I will be very pleased to take your questions.

In terms of trading, if you go back to December 2010, we set out some pretty ambitious targets for the group, growing like for like volume, growing return on sales, growing return on capital employed, and we're very pleased with the progress that has been made this year. And this performance during the year reflects the resilience of our FMCG customer base, and the importance of having a pan European network. We saw a particularly strong performance on the continent over the last year.

And in our plastic packaging business, particularly the liquid packaging dispensing, we've also seen very good progress in that business. So overall, substantial progress during the year, and let's not forget, generally, the economic environment is pretty challenging.

So as many of you know, these targets that we set in December 2010, we're pleased to report, we're made excellent progress towards the cost and capital efficiencies we identified. We expect to hit our target for working capital to revenue of 5% or less, this year-end, and our return on average capital employed, well within our target range.

So it's been a very busy and eventful year for DS Smith, as well as driving and improving the organic growth, and working towards the operational and financial targets we've set ourselves, we also announced a proposed 1.6 billion acquisition of SCA Packaging. This is a transformative transaction, which will bring something new and very exciting to the

industry. It'll position the large group as the leading supplier for recycled packaging across Europe.

So far we're very pleased with how things have gone, everything is progressing in line with our expectations. The most recent development has been completing the necessary consultation with all the relevant works councils, including those in France, which means that the acquisition of the French business will now follow the same timetable as the rest of SCA Packaging.

And I would also like to take the opportunity to mention just how positive the responses have been towards the transaction, not only from our employees and the works councils, but from our customers, as well.

It is clear to me that everyone can see that this transaction, when it completes, makes excellent commercial sense for everyone involved in both business. It is genuinely an exciting time for everyone associated with both businesses.

And finally, a few words regarding the outlook; the board remains very confident about the prospects of DS Smith, both next year, and in the medium term. The improvements made across the business over the last 18 months make DS Smith stronger than it's ever been before, and we're on track towards completing the transformative acquisition of SCA Packaging by the end of Q2. Steve and I would now welcome any questions you may have.

- LO Thank you, Miles. Ladies and gentlemen, if you would like to ask a question, please press star, one, on your telephone keypad. If you change your mind and wish to withdraw your question, please press star, one, again. You will be advised when to ask your question. Our first question comes from Ross Gilardi from Merrill Lynch. Please go ahead.
- RG Good morning, gentlemen. I just have one or two questions. First, obviously, we've got SCAs discontinued earnings last week, and you put out your supplementary prospectus, but we've got an after tax number, can you, by chance, give us a pre-tax EBITDA number for the first quarter?
- SD It's Steve, here, Ross. No, I can't, because of all the rules and regulations that Miles just spoke to you about, so that's why I don't want to give a specific number out, because that would have to be audited, and then I'd have to issue a new prospectus. What I can say is, there is nothing strange or unusual to arrive at that after tax number, from SCA.
- RG But there would be some taxes and interest also, you can't just pre-tax the after tax number and use an average exchange rate, right? There'd be some other adjustments, as well?
- SD Absolutely, because you'd know from the prospectus, there's a certain amount of debt within the SCA Packaging number, in what's disclosed, so you're absolutely right to say there'd be interest and the tax. What I can say to you is, there is nothing unusual in arriving at that after tax number, in terms of finance costs or taxation.
- RG Great. And then can you just comment, at all, where like for like trends have come in since the end of December, and any difference in countries or end markets that you're noticing?
- MR Yes. We set our targets to grow consistently ahead of GDP, by 1% or better, and pretty much we've followed that trend during the year. There's no doubt some of the economies

have been a little bit weaker in the second half of, certainly, post December. But we're talking about small differences, is it sort of half percent, or plus point one, etc, so as the economies have generally softened a bit, we've obviously seen that, but we have maintained our growth ahead of the GDP.

But what we've seen is, generally, we've had a very strong continued performance on the Continent, and when you go into that, Eastern Europe's been very strong, France has been good for us, and Italy, where we have quite a modest business there, but that's actually continued to trade pretty well. It's been very good.

But of course, this is all because we're so focused on the FMCG sector, and people continue to eat and drink. And whilst the industrial sector has come off, exposure to that is more limited, it's meant that our like for like has stayed very resilient. And don't forget, our revenue like for like is considerably ahead of this. So overall, we're feeling pretty pleased about it.

RG Terrific. And then just lastly, can you give any comments on outlook for fiscal 2013, with respect to your existing business, so excluding SCA, and your ability to grow margin, expand margin again, this year, given, as you've flagged, the volatile cost environment? Is there a chance that we have a pause in margin for your business, or even a modest decline, or do you think you'd continue to expend the margin?

MR What are we allowed to say on this?

SD I think we could refer back to December, in a sense, that nothing's really changed. If you remember when we were still up in December, we gave you a view of the amount of profit that was coming from paper, and that we expected that to be under pressure, looking into next year, and equally, we felt there was enough within the base business, in terms of self-help, of what we were working on, in terms of cost reduction, to mean that we would offset that pressure that was on paper

But you're actually right, Ross, in terms of pressure on the paper business, in terms of rising costs, and trying to pass that through, and of course, you have the normal, in a rising cost environment, you have the normal three month delay within DS Smith, because that's how we've constructed our commercial contracts for that.

So what we said in December, as I sit here now, equally applies. Paper business under pressure, usual lag in terms of cost recovery, but enough there within DS Smith in terms of the acquisitions, Otor, the restructuring, making the UK and our other businesses more efficient, all those themes still apply.

MR I think the City is expecting, for next year, for returns, generally, to go up, and we're quite comfortable with that, despite paper coming off. As Steve said, we've got a lot of actions in DS Smith, and we're very comfortable with what they're expecting. No great concerns about that. We're pleased not only at the progress this year, but the underlying confidence, and the improvement in processes and improvements in skills that we're building in to the company, and again, let's not forget, during the time of substantial development for the group, as well, so it's keeping the core business going, at the same time as obviously bringing in what, for us, in a very substantial acquisition, and disposing of Spicers. So overall, feeling okay about it.

RG And what do you think all the changes at Tesco mean for your business? Because obviously, there are a lot of things happening there, and a lot of big strategic initiatives that they, from an outsider's perspective, they seem to be considering?

MR Yes, if you... Firstly, Tesco are a very substantial organisation, and even if their volumes, their like for like can vary, it is still a huge organisation in the UK retail market. Obviously, going forward, the UK is about 20% of our business, so it's a big player in the UK, which is 20% of DS Smith. I think what's important is that whilst Tesco may be varying slightly, other retailers continue to show, generally, on the High Streets and the big grocery retailers, continue to show good growth and development.

So if Tesco does go up and down a bit, it's not a big exposure to us. Generally, the retail sector, where we're very focused in food and drink continues to go forward. In terms of the specific changes of Tesco, more people in store, etc, they're not making any changes to the use of shelf-ready packaging. If anything, we continue to see a very good progress there, and also, rolling that out into their eastern European stores, and as you know, we do all the recycling there, as well. So as I say generally, momentum with that customer is pretty good for us.

RG Thank you very much.

LO Thank you. Your next question today comes from the line of Marcus Almerud from Morgan Stanley. Please go ahead.

MA Hi, guys, can you hear me?

MR Hi, good morning.

MA Hi, Marcus Almerud here. Very quickly, how soon after you close the deal, do you think you will be able to give us a full update on where you're going and give us more details on SCA?

MR Absolutely. We set out, at the time of the acquisition, that within 100 days of completing the deal, so if it completes at the end of June, within 100 days, we'll be coming back to shareholders and explaining exactly how we see the development of the acquisition. We're talking about synergies with the cost working capital and revenue, we're talking about management structures, we're talking about how we see the next two years, in terms of real value that, in terms of strengthening the business model, 100 days for a very good run through of how we see that business.

MA And do you have any access to the company now, or is it completely separate entity until the deal is closed? Do you have continuous access with the business and you can prepare for integration, etc?

MR Just as we have lots of restrictions around us because of the prospectus, we have lots of restrictions around us because of the competition clearance, and you have to operate both businesses on a completely stand-alone basis. Having said that, we did agree that we would have certain rights to access the business, to understand various parts of it, and all of those are being honoured. So we are getting the access that we expected to receive. Obviously I'd like there to be more, but we are constrained by the EU. But everything, the access we're getting is exactly as we expected to receive.

MA And then finally, a little bit more about the trading environment about paper price and also corrugate pricing, paper prices moving up at the moment, you are short of paper, so I assume you are seeing some margin pressure at the moment, but can you talk a little bit about where you see OCC prices moving, where you see on the paper price, what you see on the corrugated pricing side, and I assume you will be able to compensate for that, as you have in the past, if nothing has changed that. If you can talk a little bit about that.

MR Firstly, in terms of our pricing, and being able to recover our cost increases, absolutely nothing's changed there at all. We've been very successful in the past, we've got good processes, good understanding, and an improving contract structure with our customers, and indeed, we're already talking to them about what we think might happen in the future. Now, at the moment, paper prices have been going up, fibre costs are high, energy is high, distribution is high. If you ask me what it's going to be in three months' time, the honest answer is, I haven't got a clue.

If anybody can predict the price...anybody predict the price of paper in one month time, then they've got access to information that frankly, well, we're just unaware of anybody who has that sort of visibility. I wouldn't be surprised if they continue to increase. Equally, I wouldn't be surprised if they stayed the same. I think a fall in prices is probably less likely, but where they're going to be... But that's why we have our business model. That's why we've reduced the contract period. That's why our service and our quality has improved so much, to enable us to work to recover these costs, in whichever way they go.

So we will focus more on, how do we provide value to our customers? And frankly, we worry less about what the price of paper is going to be, because we just haven't got a clue. That's the truth of it.

MA And just for modelling purposes, if I can just ask, I know that before, you had about four months lag between the pricing of the paper, and for you being able to compensate that; just so I can understand the lag, and in my estimate, is that still valid, the four months?

SD Hi, Marcus, Steve here. I think we've always tried to guide you that way. We were at six months, probably 18 months ago now, and we were down to nearly three months. Obviously that's a process, as we go through renewing contracts with our customers, that is continually improving, but you should be using about just every three months.

MA Perfect. Thank you very much.

LO Thank you. Our next question today comes from the line of Hector Forsythe from Oriol. Please go ahead.

HF Hi, good morning. I think a couple of questions I wanted to ask have come through, but there was a couple of things in the statement I just thought I'd like to have a little bit of clarity on, which would be really good. You've mentioned that you've seen improved performance on the corrugated packaging. Do you want to just flesh that out a little bit? And the second bit under there is, in terms of the UK business has been restructured, can you also rattle through exactly what you've done there? Thank you.

MR We've set out to, back in December 2010, how we wanted to change and improve the business to really enhance the returns to shareholders, so it's more consistency of earnings,

high return on sales, high return on capital, and a really great cash flow. And at the time, we set out some targets that were seen as quite ambitious, for a company in our industry. And over the last year, we have made very significant progress towards them.

So exiting this year, the business is certainly in a much stronger position than it has been in the past, and frankly, we're expecting to see that in the numbers.

When it comes to the specific areas, how do we achieve that, it is by focussing on the right customer segment, and the right product categories within that, so either customers with a very resilient demand, that we can work with in the long term, and who really want innovation, because that drives margin, and that drives a consistency about asset utilisation, as well. So we focus very heavily in that sector.

When it comes to our margins, we announced back in December 2010 that we were going to improve the cost base, significantly in the UK, where we have a lot of separate operations. We've been working on that, and there are some very significant restructuring in the UK, at the moment. All, as we said, will work on bringing the different divisions in the UK together, when it comes to the back office functions, so avoiding duplication, providing a better service to our suppliers and our customers, for our shareholders, operating at a much lower cost, and therefore, improved Return on capital.

And that's basically what's been happening this year, and that'll continue for... Some of these projects are longer term, so we've probably got about another six or seven months to run on some of those projects in the UK.

HF Thank you. So you're not, in that statement, you're not flagging something new, you're flagging the on-going change?

MR No, this is, everything is absolutely as we outlined back in 2010.

SD Yes, most of it, when Gary stood up, we did that capital markets day, if you remember, last year, where our UK manager stood up and talked about how he was bringing the UK together to make it more efficient with lower cost, removing the duplication that existed and that's is very much a continuation of this programme.

HF Thank you ever so much for that clarification.

MR Thank you.

LO Thank you. And a final reminder, ladies and gentlemen. If you would like to ask a question, please press star, one, on your telephone keypad now. Miles, we have no further questions coming through, so if I could hand back to you to close today's call.

MR Firstly, thank you, everybody, for your time. We do appreciate it. As I've said, the positive trading momentum has continues, volume growth and improvement in our financial metrics. We have continued to work towards a significant cost and capital efficiencies that we outlined back in December 2010. The proposed acquisition of SCA Packaging is progressing fully in line with our expectations, and we've been very encouraged by the responses and feedback today.

So overall, the board is pleased with what we've achieved during this year, and really, we're very excited about our prospects for the coming year and the medium term. I look forward to meeting you all again towards the end of June, when we'll be outlining our full year results, and giving an update on trading, generally. Thank you for your time.

LO Ladies and gentlemen, thank you for joining. You may now replace your handsets.